

REICHOLD CHEMICALS (CANADA) LIMITED

Price

January 8, 1969 \$13 1/2

Earnings per share

December 31, 1967 \$0.99
1968 (est.) \$0.80
1969 (est.) \$1.05

P. E. Ratio (on 1969 est.) 12.9X

Indicated dividend \$0.24

Yield 1.8%



Chart Courtesy Investors Stock Charts Ltd.

The Company Reichold Chemicals (Canada) Limited ("Reichhold"), of which Reichhold Chemicals, Inc. of Delaware owns 35%, is engaged primarily in the manufacture of synthetic resins used for surface coatings, bonding and adhesion; plastics and plastic molding compounds; printing inks; and various industrial chemicals. The Company also imports specialty chemical products from its U.S. affiliate for resale in Canada. For the year ended December 31, 1967, the Company reported sales of \$13.3 million and profit of \$451,000, up 10.7% and 22.6% respectively from the previous year.

Operations The Company and its two subsidiaries operate 8 plants and 4 customer service centres in five provinces across Canada. Sales offices are maintained at each plant location and the Company's head office is in Toronto.

During the period from 1963 to 1968, the Company spent about \$4.5 million to expand existing plant facilities. In 1968, the Company further expanded its operations by acquiring 100% of the common stock of Canada Printing Ink Company Limited of Toronto, a manufacturer of a full line of printing inks. This acquisition is indicative of the Company's long-range plan to expand and diversify its overall base of operations within the chemical industry.

Sales From 1958 to 1967, Reichhold's sales grew at an average annual rate of 9.6%, but during the period 1962 to 1967, this growth rate was 14.8%. For the first nine months of 1968, Reichhold's sales of \$11.6 million were up 15.8% over the comparable 1967 period.

In 1967, about 37% of the Company's revenues were derived from the sale of resins sold to paint, floor wax and surface coating manufacturers. Another 27% of the Company's sales were derived from resins used by the forest products, plywood, particle board and paper industries for bonding and adhesion; 21% of the Company's sales came from plastics and plastic molding compounds used by the electrical appliances, transportation, recreation and decorative industries; and the remaining 15% of Reichhold's sales came from decorative overlays and specialty industrial resins and chemicals.

The outlook for the Company's sales over the medium term is for continued moderate growth in the Company's resin sales and above average growth in sales of printing inks, plastics and specialty chemical products. We expect the Company's overall internal sales growth rate to approximate 12% — 14% over the medium term, although 1968 and 1969 sales will show above average increases because of the Company's recent acquisition.

Operating Profit The Company's operating profit for the year ended December 31, 1967 was \$1.5 million or 11.2% of sales.

Reichhold's operating profit margin has fluctuated between 10.2% and 13.3% from 1963 to 1967. These margin fluctuations have been due to product price erosion, fluctuations in raw material costs, a large write off of an obsolete plant in 1965 and the aftermath of a serious fire in 1966. Also, a severe price squeeze between

raw materials and finished products in the first quarter of 1968 and the inclusion of the less profitable operations of Canada Printing Ink reduced Reichhold's operating margin for the first nine months of 1968.

We expect that the Company's operating margin for fiscal 1968 will be about 9.2%, and for 1969, we expect this margin to improve to about 9.5% due largely to the expected improvement in the profitability of Canada Printing Ink and the beneficial effects to be derived from the Company's recent expansion program.

Net Profit In 1967, Reichhold reported net profit to common of shareholders of \$427,000 equivalent to \$0.99 per share.

From 1964 to 1966, the Company reported declining earnings per share from \$0.97 to \$0.80, but before provision for certain non-recurring expenses in 1965 and 1966, earnings actually increased from \$0.97 to \$1.05. On this basis, 1967 earnings were about flat and full 1968 earnings should be down substantially due mainly to a poor first quarter when the severe price squeeze occurred.

In 1969, however, continued sales growth, improvement in Canada Printing Ink's operations and a further reduction in the Company's fixed preferred dividend charge should account for earnings per share of about \$1.05. Despite the corporation income tax surcharge, the Company's tax rate should approximate 49%—50% for 1968 and 1969 as the Company obtains tax relief from certain research and development expenditures.

	(\$'000)						
	Actual					Estimated	
	1963	1964	1965	1966	1967	1968	1969
Sales	\$7,559	\$9,713	\$11,231	\$12,000	\$13,286	\$16,100	\$19,750
Less: Operating costs	6,665	8,422	9,896	10,777	11,794	14,614	17,870
Operating profit	\$ 894	\$1,291	\$ 1,335	\$ 1,223	\$ 1,492	\$ 1,486	\$ 1,880
Add: Other income	5	(19)	16	8	110	50	—
Less: Depreciation	285	329	418	479	586	625	700
Interest	47	48	50	75	130	145	160
Profit before taxes	\$ 567	\$ 895	\$ 883	\$ 677	\$ 886	\$ 766	\$ 1,020
Income taxes	317	451	458	309	435	375	510
Net profit	\$ 250	\$ 444	\$ 425	\$ 368	\$ 451	\$ 391	\$ 510
Preferred dividends	24	24	24	24	24	6	—
Net available to common	\$ 226	\$ 420	\$ 401	\$ 344	\$ 427	\$ 385	\$ 510
Shares outstanding ('000)	431	431	431	431	431	481	481
Earnings per share	\$ 0.52	\$ 0.97	\$ 0.93	\$ 0.80	\$ 0.99	\$ 0.80	\$ 1.05

Analysis

% increase (decrease) in:

Sales	13.1%	28.5%	15.6%	6.8%	10.7%	21.2%	22.7%
Earnings per share	1.3%	86.0%	(4.5%)	(14.0%)	23.8%	(19.2%)	31.3%
Operating profit margin	11.8%	13.3%	11.9%	10.2%	11.2%	9.2%	9.5%
Apparent tax rate	55.9%	50.4%	51.9%	45.6%	49.1%	49.0%	50.0%
Net profit margin	3.3%	4.6%	3.9%	3.1%	3.4%	2.4%	2.6%

Market Action From mid-1967 to November 1968, Reichhold's stock was consolidating in the \$9—\$11 range but the recent move through \$11, where the stock had met considerable resistance, represented a nine year high. Technically, the stock is now in an uptrend.

Reichhold's shares traded less than 800 per week prior to the recent 3-for-1 stock split, but we now expect an improvement in the marketability of the shares. At their current price of \$13 1/2, the shares are trading at 12.9 times our 1969 earnings estimate of \$1.05 per share and the yield on the \$0.24 dividend is 1.8%.

Comment Over the past five years, Reichhold's sales have grown at an average annual rate of about 15%, while reported earnings have fluctuated within the range of \$0.80 to \$0.99 per share.

Reichhold is a small but progressive Canadian chemical company whose shares have sold at low multiples in relation to other Canadian chemical companies. This may be attributed in part to the size of the Company's operations, to its relatively poor earnings record, and in part, to the limited availability of the shares. However, with the expectations of continued high sales growth and an upward trend for earnings after 1968, combined with the improved marketability of the Company's shares subsequent to the recent stock split, we feel that a multiple range of 14X — 16X could be warranted.

At its current price, we recommend that Reichhold's stock be purchased for above average medium term capital appreciation.

The following list includes the name of every director of Pitfield, Mackay, Ross & Company Limited and of every person having an interest, either directly or indirectly, to the extent of not less than 5% in the capital of Pitfield, Mackay, Ross & Company Limited: W. C. Pitfield, E. F. C. Kinnear, R. L. Hunter, D. L. Torrey, K. A. Wright, H. H. Mackay, P. J. Smith, W. Y. Soper, J. M. Arbour, S. J. Langill, K. M. Sedgewick, J. M. McAvity, W. G. H. Pavey, D. J. Langill, H. A. Wheeler, D. C. Mackay, C. B. Loewen, A. F. MacAllaster, T. H. Baker, E. R. Pope, B. E. Thompson.